93-827

No.

Supreme Court, U.S.
FILED
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

BALCOR FILM INVESTORS, *et al.*,

Petitioners,

v.

ROBERT ECKSTEIN and SYLVIA ECKSTEIN, *et al.*,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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70 pp

QUESTIONS PRESENTED

1. Whether the Seventh Circuit correctly interpreted Section 27A of the Securities Exchange Act of 1934 as codifying a "non-uniform federal law" requiring a federal court to apply the statute of limitations law of the transferor forum, and not its own statute of limitations, to a federal question case transferred pursuant to 28 U.S.C. § 1404(a), in light of a conflicting interpretation of Section 27A by the United States Court of Appeals for the Second Circuit in *Menowitz v. Brown*, 991 F.2d 36 (2d Cir. 1993), and this Court's decision in *DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151 (1983), which held that the statute of limitations question in a federal question case is itself a federal question?

2. Whether the holdings of *Ferens v. John Deere Co.*, 494 U.S. 576 (1990), and *Van Dusen v. Barrack*, 376 U.S. 612 (1964)—that a transferee court must follow the rules of the transferor forum pursuant to 28 U.S.C. § 1404(a)—apply whenever the law of the United States is "geographically non-uniform," regardless of whether the action at issue arises out of a federal question or diversity claim?

3. Whether a litigant's decision to file in one federal forum as opposed to another constitutes sufficient "reliance" under *Chevron Oil v. Huson*, 404 U.S. 97 (1971), and *McCool v. Strata Oil Co.*, 972 F.2d 1452 (7th Cir. 1992), to avoid retroactive application of subsequent decisions affecting the limitations period in the chosen forum?

LIST OF PARTIES

Petitioners/defendants include Balcor Film Investors, Balcor Entertainment Company, Ltd., The Balcor Company, f/k/a Balcor/American Express, Inc., Balcor Securities Company, New World Pictures, Ltd., New World Entertainment, Ltd., The American Express Company, Lehman Brothers Inc., f/k/a Shearson Lehman Hutton, Inc., f/k/a Shearson Lehman Brothers, Inc., and f/k/a Shearson Lehman/American Express, Inc., Jerry M. Reinsdorf, Robert A. Judelson, James E. Finley, Gregory S. Junkin, Barry R. Jackson, Lawrence L. Kuppin, Robert Rehme and Harry E. Sloan. Respondents/plaintiffs include Robert Eckstein, Sylvia Eckstein, Ralph Majeski, Joseph Yach, Janice Waisman, Larry R. Peterson, Thomas Weil, Lee Aldridge, Randy Karpinsky, Kenneth Kulas, Robb S. Elliott and Raymond Harding.

The following is furnished in compliance with Supreme Court Rule 29.1:

Balcor Entertainment Company, Ltd.
Parent Company - The Balcor Company
Subsidiaries (except wholly owned) - None

The Balcor Company
Parent Company - National Express Company
Subsidiaries (except wholly owned) - None

Balcor Securities Company
Parent Company - The Balcor Company
Subsidiaries (except wholly owned) - None

New World Entertainment, Ltd.
Parent Company - Andrews Group Incorporated
Subsidiaries (except wholly owned) - None

New World Pictures, Ltd.
See New World Entertainment, Ltd.

The American Express Company
Parent Company - None
Subsidiaries (except wholly owned) - First Data Corp.

Lehman Brothers Inc.
Parent Company - The American Express Company
Subsidiaries (except wholly owned) - None

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Balcor Film Investors, Balcor Entertainment Company, Ltd., The Balcor Company, f/k/a Balcor/American Express Inc., Balcor Securities Company, New World Pictures, Ltd., New World Entertainment, Ltd., The American Express Company, Lehman Brothers Inc., f/k/a Shearson Lehman Hutton, Inc., and f/k/a Shearson Lehman/American Express, Inc., Jerry M. Reinsdorf, Robert A. Judelson, James E. Finley, Gregory S. Junkin, Barry R. Jackson, Lawrence L. Kuppin, Robert Rehme and Harry E. Sloan respectfully petition for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this proceeding on August 20, 1993.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,712 (7th Cir. Aug. 20, 1993). App. 1-20. The decision of the District Court is reported at 786 F. Supp. 1458 (E.D. Wis. 1992). App. 23-44.

JURISDICTION

The judgment of the Court of Appeals was entered on August 20, 1993. App. 21. The jurisdiction of this Court to review that judgment by writ of certiorari is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides in relevant part that

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commence or of the mails or of any facility of any national securities exchange
>
> * * *
>
> (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contradiction of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 27A of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa-1(a), provides in relevant part that

> The limitation period for any private civil action implied under section 78j(b) of this title that was commenced on or before June 19, 1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991.

Section 1404(a) of the Judiciary and Judicial Procedure Act, 28 U.S.C. § 1404(a), provides that

> For the convenience of the parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought.

STATEMENT OF THE CASE

Majeski v. Balcor Entertainment Company, No. 88 C 1079 ("*Majeski*"), was filed by ten Wisconsin investors on October 11, 1988, in the United States District Court for the Eastern District of Wisconsin ("Eastern District of Wisconsin" or the "District Court") as a putative class action on behalf of all persons who purchased limited partnership interests in Balcor Film Investors ("BFI"). BFI was a limited partnership formed in 1984 to produce and distribute low-budget movies pursuant to an agreement with New World Entertainment, Ltd. ("New World"). *Majeski*'s Amended Complaint asserted claims under Section 10(b) of the Securities Exchange Act of 1934, Sections 12(2) and 17 of the Securities Act of 1933 and various common law claims.[1] In essence, the *Majeski* plaintiffs alleged that BFI was misrepresented as being a safe and conservative investment, when in fact it was highly speculative.

Eckstein v. Balcor Film Investors, No. 89 C 1315 ("*Eckstein*"), another putative class action also seeking to represent all BFI limited partners, was filed on February 10, 1989 in the United States District Court for the Central District of California ("Central District of California"). *Eckstein* also asserted Section 10(b) and common law claims, although the latter were dismissed *sua sponte* by the lower California court. The *Eckstein* Section 10(b) claim alleged a "fraud created the market" theory, assert-

[1] The District Court ultimately dismissed the *Majeski* plaintiffs' Section 17 and Section 12(2) claims. The District Court dismissed the Section 12(2) claim for failure to adequately plead the one year/three year limitations period set forth in 15 U.S.C. § 77m. *Majeski v. Balcor Entertainment Co., Ltd.*, 740 F. Supp. 563, 566-67 (E.D. Wis. 1990). The *Majeski* plaintiffs did not seek appellate review of that decision.

ing that, but for the alleged misrepresentations and omissions, the BFI offering would not have been successful.

Both actions arose from the offering of BFI limited partnership interests which were sold pursuant to a Prospectus dated January 8, 1985. The offering was limited to investors who met certain financial and suitability requirements and who had no need for liquidity in their investment given the lack of a secondary market for the partnership interests. Investors were warned that there could be no assurance that the partnership's objectives of a return on investment, appreciation in BFI's investments and tax benefits, would be achieved. In addition, the Prospectus cautioned that an investment in BFI was not only subject to all of the significant risks inherent in an investment in the motion picture industry, but that BFI's success was also dependent upon the results achieved through New World's performance in developing, acquiring, producing and distributing the BFI movies.

On August 23, 1989, on defendants' motion, the Judicial Panel for Multidistrict Litigation transferred the *Eckstein* action to the Eastern District of Wisconsin pursuant to 28 U.S.C. § 1407 for consolidated pretrial proceedings with *Majeski. In re Balcor Film Investors Sec. Litig.*, No. 805 (J.P.M.L. Aug. 23, 1989). On February 27, 1991, the District Court permanently transferred *Eckstein* to the Eastern District of Wisconsin pursuant to 28 U.S.C. § 1404(a) and Fed. R. Civ. P. 42(a).[2] App. 23 n.1.

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[2] In the interim, on January 18, 1991, the District Court certified one class of all persons who purchased interests in BFI, and created two separate subclasses—an *Eckstein* subclass comprised of "all persons who purchased [BFI Interests] *without* relying on any of the public offering materials" and a *Majeski* subclass of purchasers who relied on the offering materials in making their investments. *Majeski v. Balcor Entertainment Co., Ltd.*, 134 F.R.D. 240 (E.D. Wis. 1991) (emphasis in original).

On March 11, 1992, the District Court granted petitioners' motions for summary judgment in both actions. App. 42, 45-46. The District Court found that *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 2887 (1991), which adopted the one year/three year statute of limitations for claims brought pursuant to Section 10(b) set forth in 15 U.S.C. § 77m, applied retroactively to both actions and that, as a consequence, both actions were time barred. App. 28-29, 40, 42. With reference to *Eckstein*, the District Court held that under Section 27A and *In re Korean Air Lines Disaster*, 829 F.2d 1171 (D.C. Cir. 1987) (Ruth B. Ginsberg, J.), *aff'd on other grounds sub nom. Chan v. Korean Air Lines, Ltd.*, 490 U.S. 122 (1989), its own law, and not that of the transferor California forum, applied. App. 26-27. The District Court thus dismissed *Eckstein* pursuant to *Short* because it was filed after the three year period of 15 U.S.C. § 77m had expired. App. 42. The District Court found that the *Majeski* action was also time barred pursuant to 15 U.S.C. §77m because it was not filed within one year after plaintiffs were placed on inquiry notice of the alleged fraud. App. 40-41.

On August 20, 1993, the Seventh Circuit vacated the District Court's judgments and remanded the cases for further proceedings. App. 20-21. Specifically, in connection with *Eckstein*, the Court of Appeals held that the language of Section 27A, requiring the application of the statute of limitations of "the jurisdiction" to Section 10(b) cases filed before June 20, 1991, implied that Section 27A codified "geographically non-uniform" federal law, *i.e.*, a federal law wherein different federal courts applied different rules. App. 8-9. Based on that interpretation of Section 27A, and its interpretation of *Van Dusen v. Barrack*, 376 U.S. 612 (1964), and *Ferens v. John Deere Co.*, 494 U.S.

516 (1990), the Court of Appeals held that the rule of the transferor forum, rather than its own rule, applied to *Eckstein*. Thus, the Court declined to impose *Short*'s one year/three year statute of limitations to *Eckstein* (since the law of the Central District of California, *Eckstein*'s forum of filing, applied) and remanded the action. App. 8-9.

With regard to *Majeski*, the Court of Appeals held that Section 27A required the District Court to analyze whether *Short*'s statute of limitations should be retroactively applied by using the test articulated in *Chevron Oil v. Huson*, 404 U.S. 97 (1971) (as interpreted by *McCool v. Strata Oil Co.*, 972 F.2d 1452 (7th Cir. 1992)), to determine if plaintiffs had relied on pre-*Short* law. Since the District Court did not perform such an analysis, the Court of Appeals vacated the District Court's judgment and remanded the case for further proceedings consistent with its opinion. App. 12-13. However, in addressing the issue of what could satisfy *Chevron Oil* and *McCool*, the Court of Appeals advised that a plaintiff's decision not to file in one forum and to proceed instead in another could constitute sufficient reliance under *Chevron Oil* to prevent the retroactive application of a new rule of law. App. 13.

Petitioners seek review of the Court of Appeals' holdings that: (i) Section 27A, which instructs courts to apply the statute of limitations of "the jurisdiction" to cases filed before June 20, 1991, has codified "non-uniform federal law" mandating that the law of the transferor forum, and not that of the transferee forum, be applied to cases transferred pursuant to 28 U.S.C. § 1404(a); (ii) the principles of *Van Dusen* and *Ferens* apply to both diversity and federal question claims; and (iii) a party's decision to file in one forum as opposed to another is a sufficient form of reliance under *Chevron Oil* to avoid retroactive application of a new rule of law.

REASONS FOR GRANTING THE WRIT

Summary

The writ should be granted because the Court of Appeals' interpretation of Section 27A has resulted in the application of two different rules of law, that of the Seventh Circuit and that of the Ninth Circuit, to two federal cases which are pending in the same court; have been brought on behalf of the same parties, *i.e.*, all limited partners of Balcor Film Investors; are asserting the same federal claims; and have been consolidated for all purposes. The decision of the Seventh Circuit conflicts with *Menowitz v. Brown*, 991 F.2d 36 (2d Cir. 1993), which recognized the unitary nature of federal law and held that a transferee court should apply its own rule of law rather than that of the transferor forum in determining the appropriate statute of limitations under Section 27A.

In addition, the Court of Appeals' interpretation of Section 27A is at odds with this Court's holding in *DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151 (1983), in which the Court affirmed the unitary nature of federal statute of limitations questions in finding that the issue of the proper statute of limitations to be applied in a federal question case is itself a federal question. Moreover, the Court of Appeals' holding extends the diversity principles articulated in *Van Dusen* and *Ferens* to federal question cases, a holding also inconsistent with *Menowitz* and with the decision of United States Court of Appeals for the District of Columbia Circuit in *Korean Air Lines*. Finally, in interpreting Section 27A as implying a Congressional intent to insure that pre-June 20, 1991 Section 10(b) statute of limitations questions are decided on the basis of where the litigation was filed and could have been filed rather than where it was pending on June

19, 1991, the Court of Appeals has blurred both the line between state and federal law and the meaning of reliance under *Chevron Oil*. For all these reasons, it is appropriate that this Court grant the petition for writ of certiorari seeking review of the Court of Appeals' decision.

I.

THE DECISION BELOW CONFLICTS WITH THE DECISION OF THE SECOND CIRCUIT IN *MENOWITZ*.

Section 27A directs that the limitations period applicable to a Section 10(b) case filed prior to June 20, 1991 is the limitations period "provided by the laws applicable in the jurisdiction" as they existed on June 19, 1991. 15 U.S.C. §78aa-1(a). When given its natural meaning, the statute refers to "the jurisdiction" in which a Section 10(b) case was pending as of June 19, 1991.

In *Menowitz*, the Second Circuit held that, in determining the statute of limitations law of "the jurisdiction" under Section 27A, a transferee court should apply the law of its own circuit, *i.e.*, where the transferred case was pending as of June 19, 1991, rather than that of the transferor forum in which the case was filed. 991 F.2d at 40. The Seventh Circuit, however, held the reverse, finding that Section 27A requires a transferee court to apply the law of the transferor forum, the jurisdiction in which the case was filed, rather than its own law. App. 8-9. Thus, the decision below conflicts with the decision of the Second Circuit in *Menowitz*, a conflict which the Seventh Circuit expressly noted in its decision. App. 9 n.†.

II.

THE SEVENTH CIRCUIT'S INTERPRETATION OF SECTION 27A IS INCONSISTENT WITH *DELCOSTELLO* AND RAISES QUESTIONS REGARDING THE PROPER SCOPE OF *VAN DUSEN* AND *FERENS*.

Not only does the decision below directly conflict with the Second Circuit's decision in *Menowitz*, it is inconsistent with this Court's decision in *DelCostello* and is at odds with the plain language of the statute and its legislative history. It also raises serious issues regarding the proper construction and scope of this Court's decisions in *Van Dusen* and *Ferens*, which should be settled by this Court.

The court below, without addressing the legislative history of Section 27A or this Court's decision in *DelCostello*, came to the conclusion that Congress' reference to "the jurisdiction" in Section 27A constituted a recognition that, prior to June 20, 1991, different circuits applied different statutes of limitations to Section 10(b) cases and thus codified the "non-uniform" nature of statutes of limitations for Section 10(b) cases filed before June 20, 1991. App. 8-9. It further held that, whenever a federal court is faced with a case transferred under Section 1404(a) wherein such a "non-uniform federal law" is at issue, the diversity principles articulated in *Ferens* and *Van Dusen* pertain. App. 9. Accordingly, even though *Eckstein* was based on a federal claim, and was pending in "the jurisdiction" of the Eastern District of Wisconsin on June 19, 1991, the Court of Appeals found that Section 27A coupled with *Ferens* and *Van Dusen* required the statute of limitations of the transferor forum, the Central District of California, and not that of the transferee forum, to be applied to *Eckstein*. *Id.*

With regard to *Majeski*, the Court of Appeals found that Section 27A required it to apply the *Chevron Oil* test to the question of whether *Short*'s one year/three year limitations period applied retroactively to the *Majeski* plaintiffs' claims. It also found the dispositive question on that issue to be: if those plaintiffs had known that *Short* would apply to their claims, could and would they have filed within the period of limitations? The Court stated that those plaintiffs might have satisfied *Chevron Oil* and *McCool* by filing their action in Wisconsin when they could have chosen to file their action in California. App. 13.

The result of the Seventh Circuit's reasoning is one which is an anathema to the national policy of uniformity in the application of federal laws. *Eckstein*, a Section 10(b) case with no pendent state law claims, was transferred to the Eastern District of Wisconsin pursuant to 28 U.S.C. § 1407(a) for coordinated or consolidated proceedings with *Majeski*, another Section 10(b) case already on file in Wisconsin. The case was thereafter permanently transferred pursuant to Section 1404(a) and consolidated with *Majeski* for all purposes. The District Court certified only one class, consisting of all BFI investors. However, under the Seventh Circuit's reasoning, Section 27A's use of the generic term "the jurisdiction" mandated that the timeliness of these similar actions brought pursuant to the same federal statute on behalf of the same class be analyzed under two different statutes of limitations. Thus, under the decision below, the *Eckstein* plaintiffs received the benefit of the California state statute of limitations although their action was pending in the Wisconsin District Court, not California, on June 19, 1991. The *Majeski* plaintiffs, on the other hand, received the benefit of the Wisconsin state statute of limitations by virtue of their argument that they could have filed in California, even though

their action also was pending in the Wisconsin District Court, not California, on June 19, 1991. If Section 27A were given its common sense meaning, however, only one statute of limitations would be applied to both the *Majeski* and *Eckstein* actions.

Section 27A directs that the limitations period applicable to both *Eckstein* and *Majeski* is the limitations period of "the jurisdiction" in which *Eckstein* and *Majeski* were pending on June 19, 1991—not the jurisdiction in which *Eckstein* was filed two and one half years earlier, or where *Majeski* "could have" or "would have" been filed. This construction of Section 27A is reinforced by the fact that a proposed draft of Section 27A actually included the language "in the jurisdiction *in which such civil action was commenced.*" 137 Cong. Rec. § 17469-03 (1991) (emphasis added). That language, however, was deleted in favor of the present version which does not refer to where the "action was commenced." *See I.N.S. v. Cardoza Fonseca*, 480 U.S. 421, 442-43 (1987) ("Few principles of statutory construction are more compelling than the proposition that Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded in favor of other language."); *Tyler v. U.S.*, 929 F.2d 451, 456 n.8 (9th Cir. 1991) ("the very fact of deletion implies a legislative intent different from that in the original proposal" (citing 2A Sutherland Construction § 48.18)).

In *DelCostello*, this Court laid to rest any possible question remaining as to the nature of a borrowed state statute of limitations period in a federal claim, holding that "the choice of a limitations period for a federal cause of action is itself a question of federal law," and cautioning federal courts against allowing the use of state law in a federal question case to interfere with the national policy

of federal uniformity. 462 U.S. at 159 n.13. Congress' decision not to adopt statutory language referring to "the jurisdiction in which the action was commenced" but to refer only to "the jurisdiction," comports with this Court's ruling in *DelCostello* and confirms that a federal action's original or hypothetical original geographical origin is irrelevant to the proper application of Section 27A. Thus, the Court of Appeals' interpretation of Section 27A conflicts not only with the plain language of the statute but with this Court's pronouncement in *DelCostello* as to federal statute of limitations questions as well.

The Court of Appeals' construction of Section 27A, and its finding that *Van Dusen* and *Ferens* apply "whenever different federal courts properly use different rules" (App. 9), are also at odds with the weight of authority addressing transferred federal question claims. Courts and commentators alike have supported the premise that transferee courts should apply their own law to transferred federal question claims. *See, e.g., Korean Air Lines*, 829 F.2d at 1174-76; *In re Pittsburgh & L.E.R. Co. Sec. & Antitrust Litig.*, 543 F.2d 1058, 1065 n.19 (3d Cir. 1976). *See also* IA J. Moore, *Moore's Federal Practice* ¶ 0.345 [4.-6] (2d ed. 1993); Friendly, "The 'Law of the Circuit' And All That," 46 St. John's L. Rev. 406, 412 (1972). The logical view is that Congress, well aware of that premise and of the potentially conflicting results which could occur if different jurisdictions' statutes of limitations were to apply to two or more consolidated Section 10(b) cases, deleted the "in which the action was commenced" language from Section 27A to avoid that very conflict.

This interpretation of Congressional action is consistent with an analysis performed by then-Circuit Judge Ginsberg in *Korean Air Lines*, the seminal case addressing

the question of which choice of law rule to apply in connection with transferred federal question, as opposed to diversity, claims. Circuit Judge Ginsberg reasoned that the policies of *Erie R. Co. v. Thompkins*, 304 U.S. 64 (1938), which acknowledged a party's right to the application of the state substantive law where the case was properly filed, "did not figure in the calculus when the law to be applied is federal, not state." *Id.* at 1174. Judge Ginsberg also specifically addressed *Van Dusen* and determined that its rule was also not applicable in federal question cases. *Id.* at 1174-76. Accordingly, the court held that the law of the transferee forum would apply to the parties before it since

> it is logically inconsistent to require one judge to apply simultaneously different and conflicting interpretations of what is supposed to be a unitary federal law.

Id. at 1175-76.

In *Menowitz*, the Second Circuit followed *DelCostello* and *Korean Air Lines* in deciding to apply the transferee forum's statute of limitations to a transferred Section 10(b) case in the aftermath of Section 27A, holding that:

> [a]lthough federal courts sometimes arrive at different constructions of federal law, federal law (unlike state law) is supposed to be unitary. Thus, the rule of *Van Dusen* does not apply by analogy where a case is transferred under § 1407 to a federal court that has a different construction of relevant federal law than the federal court in which the action was filed. " '[F]ederal courts compromise a single system applying a single body of law, and no litigant has a right to have the interpretation of one federal court rather than that of another determine his case.' "

Menowitz, 991 F.2d at 40 (citations omitted). Thus, the Seventh Circuit's view that *Van Dusen*'s diversity prin-

ciples apply both to Section 27A transfer cases and whenever different federal courts apply different norms conflicts with *Menowitz* and *Korean Air Lines*.

Additionally, with regard to *Majeski*, choice of forum is not reliance in the sense meant by *Chevron Oil* for the obvious reason that it does not represent any detrimental change of position as to the timing of the lawsuit. If the timing of the action has not been affected in reliance on the existing statute of limitations, there has been no "reliance" in the ordinary sense of the term. Yet the decision below suggests that retroactivity may be avoided by the argument that, if litigants could have predicted that the law would change, they would have filed somewhere else. If that were a sufficient reason to avoid retroactivity, there would never have been any retroactive applications of a decision under a *Chevron Oil* analysis because plaintiffs virtually always have a choice of forum and every plaintiff could say "If I had known what the future would bring in this jurisdiction, I would have sued somewhere else." If that were enough to prevent retroactivity, new decisions would have applied retroactively to no one, a conclusion clearly contrary to what this Court recognized in *Chevron Oil*.

In sum, clarification by this Court is needed not only to reach a direct conflict between the Second and Seventh Circuits and to resolve divergent interpretations of the scope of the diversity principles set forth in *Van Dusen* and *Ferens*, but to determine the appropriate interplay between Section 27A, Section 1404(a) and the meaning of reliance under *Chevron Oil* where a plaintiff has a choice of forum in which to file his or her claims.

CONCLUSION

For the reasons stated, a writ of certiorari should issue to review the judgment and opinion of the Seventh Circuit.

Respectfully submitted,

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 92-1851 & 92-2510

ROBERT ECKSTEIN, *et al.*,

Plaintiffs-Appellants,

v.

BALCOR FILM INVESTORS, *et al.*,

Defendants-Appellees.

Appeals from the United States District Court
for the Eastern District of Wisconsin.
Nos. 88-C-1079 & 89-C-1315—**John W. Reynolds**, *Judge.*

ARGUED FEBRUARY 25, 1993—DECIDED AUGUST 20, 1993

Before CUMMINGS, COFFEY, and EASTERBROOK, *Circuit Judges.*

EASTERBROOK, *Circuit Judge.* By late 1984 New World Entertainment, Ltd. (New World) had experienced some success making and distributing low-budget movies. New World approached Balcor Entertainment Company, Ltd. (BEC), a subsidiary of Shearson Lehman/American Express, Inc., to solicit working capital. New World wanted to expand; BEC wanted some of the profits to be made in movies. There were the makings of a deal: BEC would obtain financing for New World's films in exchange for part of the films' profits. Because BEC didn't want to accept the risk of being the sole source of capital, it recruited outside investors. Balcor Film Investors (BFI) is

a limited partnership formed to raise money for eight to twelve low budget movies that New World would produce and distribute.

Early in 1985 BFI registered partnership interests under the Securities Act of 1933 and commenced public solicitation. Subscriptions received were to be held in escrow until $50 million had been secured. Failing to raise this amount by the deadline, BFI reduced the minimum to $35 million, offered to refund the investors' money, and began soliciting anew. By the end of 1985 $48 million was on deposit, and BFI closed the offering. During the first two years BFI supplied the tax benefits for which the investors had hoped. But New World's films flopped. In 1988 BFI told its limited partners that they were likely to lose some of their capital. Investors then filed class action suits against Shearson (now known as Shearson Lehman Hutton, Inc.), BFI, BEC, the other Balcor entities that had put together the offering, and their officers and directors (collectively Balcor). There are two groups of plaintiffs: a class of investors who read the prospectus (the Majeski plaintiffs) and a class of those who did not (the Eckstein plaintiffs). The Majeski plaintiffs assert a standard fraud theory: they purchased the limited partnership interests in reliance on the misrepresentations in the prospectus and its omissions of material facts. The Eckstein plaintiffs, whose defining characteristic is failure to read the prospectus, contend that but for the misrepresentations and omissions the offering would not have been successful. This group, in other words, asserts causation in lieu of reliance.

Although errors and omissions in the offering documents usually lead to liability under §§ 11 and 12(2) of the '33 Act, 15 U.S.C. §§ 77k, *l*(2), the plaintiffs feared that their suits would be untimely under §13 of that Act, the statute of limitations applicable to actions under §§ 11 and 12. So they invoked §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and the SEC's Rule 10b-5, 17 C.F.R. §240.10b-5. This avenue is available even though the investors complain about an initial public offering rather

than a transaction in the aftermarket. See *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). Section 10(b) and Rule 10b-5 require the investors to show *fraud*, not just material errors and omissions. In exchange they get a longer statute of limitations—or so they thought.

The Majeski plaintiffs filed in October 1988 and the Eckstein plaintiffs in February 1989. When they began the litigation, courts throughout the nation derived from state law the periods of limitations in §10(b) cases. On July 30, 1990, this court overruled opinions that had looked to state law and announced that §13 of the '33 Act supplies the statute of limitations. *Short v. Belleville Shoe Manufacturing Co.*, 908 F.2d 1385 (7th Cir. 1990). On June 20, 1991, the Supreme Court agreed with *Short* that the federal securities laws are the source of the period of limitations, but the Court selected §9(e) of the '34 Act, 15 U.S.C. §78i(e), as the most appropriate rule. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2782 n.9 (1991). Both §13 of the '33 Act and §9(e) of the '34 Act give an investor one year from discovering the facts constituting the violation, but no more than three years from the violation, to begin suit. The advantage of using §10(b) disappeared.

Congress responded to *Lampf* by enacting stopgap legislation. A new §27A of the '34 Act, 15 U.S.C. §78aa-1(a), provides that "[t]he limitation period for any private civil action implied under section [10(b) of the '34 Act] that was commenced on or before June 19, 1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991." Plaintiffs believe that this law saves their suits. The district court disagreed, dismissing both as untimely. 786 F. Supp. 1458 (E.D. Wis. 1992). Although §27A avoided *Lampf*, the district court held, it did not disturb *Short*, which was the law in the seventh circuit on June 19, 1991. And *Short*, the district court held, is fully retroactive. It concluded that *Short* governs the Eckstein plaintiffs, who filed in California, as well as the Majeski plaintiffs, who filed in Wisconsin. The Panel on

Multidistrict Litigation had transferred the Eckstein case to Wisconsin under 28 U.S.C. §1407 for consolidated pretrial proceedings, and the district court then completed the transfer by invoking 28 U.S.C. §1404(a) to make the transfer permanent. After the transfer the whole case was in Wisconsin, which the district court believed is "the jurisdiction" to which §27A refers. Both groups of plaintiffs have appealed.

I

Whether the Eckstein plaintiffs have appealed *correctly* is another matter. The Majeski plaintiffs may have destroyed the Eckstein plaintiffs' notice of appeal, leaving us without appellate jurisdiction to review the appeal of the Eckstein class. At the heart of the matter is the question: was the Eckstein case fully consolidated with the Majeski case? If the cases were fully consolidated the Eckstein appellants have problems.

Here is what happened. On March 11, 1992, the district court entered judgments dismissing both actions. The Majeski plaintiffs filed a timely motion under Fed. R. Civ. P. 59. Shortly thereafter, the Eckstein plaintiffs filed a notice of appeal. The district court denied the Rule 59 motion, and the Majeski plaintiffs filed a timely notice of appeal. Then the Eckstein plaintiffs filed what they called a "Supplemental Notice of Appeal". The clerk of this court treated that document as another notice of appeal and assigned it a new number. It did not last long: the Eckstein plaintiffs failed to pay the docketing fee, and as a notice of appeal this paper was at all events untimely, coming 34 days after the district court denied the Rule 59 motion—four more than Fed. R. App. P. 4(a)(1) permits. Thus our jurisdiction over the Eckstein plaintiffs' case depends on their notice of appeal filed before the district court acted on the Majeski plaintiffs' Rule 59 motion.

If the district court fully consolidated the cases, the Ecksteins have no valid notice of appeal and we have no appellate jurisdiction. Rule 4(a)(4) specifies the "time for

appeal for all parties" when "any party" files a timely Rule 59 motion. See *Polara v. Trans World Airlines, Inc.*, 284 F.2d 34 (2d Cir. 1960); *Continental Casualty Co. v. United States*, 167 F.2d 107 (9th Cir. 1948). If consolidation produced a single "case," then the Eckstein plaintiffs' first notice of appeal had "no effect" because it was filed before disposition of the Majeski plaintiffs' Rule 59 motion. Fed. R. App. P. 4(a)(4).

Did the district court consolidate the cases? Yes and no. As often happens, the district court did not clearly explain the extent to which the actions were consolidated. See *Ivanov-McPhee v. Washington National Insurance Co.*, 719 F.2d 927 (7th Cir. 1983). The district court ordered "the *Eckstein* and *Majeski* actions . . . consolidated for the remainder of the pretrial proceedings and trial" and certified each set of plaintiffs as a subclass of a single class of all investors in BFI. A month later the court added: "the actions are *not* consolidated for 'all purposes' *nor* are they merged into a single cause of action" (emphasis in original). What can this mean when the court had certified a single class spanning both sets of plaintiffs? Because neither case contained the entire class, if the cases were not fully consolidated, there could not have been subclasses. In *Ivanov-McPhee*, 719 F.2d at 930, we held that cases were *fully* consolidated because they could have been brought as a single unit and there was no purpose in the cases retaining separate identities. *Sandwiches, Inc. v. Wendy's International, Inc.*, 822 F.2d 707, 710 (7th Cir. 1987), adds that courts should keep in mind the relation between consolidation and appeal. Preserving formally separation may multiply the number of appeals, which should not occur when there is only one nucleus of facts. In order for plaintiffs to make up a single class their claims must have a great deal in common. Fed. R. Civ. P. 23(b)(3). We should not have to review twice claims common enough to be classed together. By all lights, the Majeski and Eckstein cases should have been consolidated for all purposes.

Nonetheless, the district court entered two judgments, just as if the suits were separate. Different plaintiffs ap-

pealed from each judgment. Appellate jurisdiction follows the judgment, providing the certainty that is essential when a misstep may forfeit a valuable right. Separate judgments are independently appealable, and no one need appeal until the formal judgment under Fed. R. Civ. P. 58 has been entered. *United States v. Indrelunas*, 411 U.S. 216, 220-22 (1973). Sometimes a party *may* appeal from a final decision not embodied in a judgment, see *Bankers Trust Co. v. Mallis*, 435 U.S. 381 (1978), but it is always entitled to wait for (and rely on) the separate Rule 58 judgment. *Shalala v. Schaefer*, 61 U.S.L.W. 4722, 4725 (U.S. June 24, 1993); *Mallis*, 435 U.S. at 386; *In re Kilgus*, 811 F.2d 1112, 1117 (7th Cir. 1987). Anything else baits a trap for unwary litigants—for wary ones, too, the kind who pay particular attention to judgments. The Eckstein plaintiffs therefore were entitled to rely on the fact that the district judge issued two judgments. They appealed in a timely manner from theirs, and the Majeski plaintiffs' motion did not affect that appeal.

II

BFI used a single prospectus for the two offerings of its partnership interests. When BFI re-offered these interests in the fall of 1985 it furnished investors with a supplement describing recent events. The plaintiffs' claims center on this supplement, which they say left out information about business reverses New World suffered in 1985. New World was making low-budget films that had limited attendance at the box office and reaped most of their profits from television and from the sale and rental of video cassettes for home viewing. A firm called Worldvision had agreed to distribute New World's films outside the theaters. According to plaintiffs, the supplement to the prospectus fraudulently omitted the fact that Worldvision and New World had had a falling out—that Worldvision, dissatisfied with the quality of the films, was attempting to withdraw as distributor and had filed a suit against New World. Plaintiffs also contend that the offering materials concealed the fact that New World was to keep the lion's share of the profits from VCR distribution.

These adverse events occurred before the investors sent in their money between October 11, 1985, and December 31, 1985. But, plaintiffs insist, they were unaware that New World had encountered troubles until BFI told them in mid-1988 that they probably would not get all of their money back. The Majeski plaintiffs filed suit in the Eastern District of Wisconsin in October 1988, while the Eckstein plaintiffs filed suit in the Central District of California in February 1989. Because different issues determine the applicable limitations period for each group of plaintiffs, we discuss them separately.

A

The Eckstein plaintiffs' case moved from California to Wisconsin under 28 U.S.C. §1404(a). Section 27A instructs us to use the "laws applicable in the jurisdiction" on June 19, 1991. The district in which the court that decides the case sits must be "the jurisdiction" for purposes of §27A. But what is the law of that jurisdiction? *Short* identifies the statute of limitations in force within the seventh circuit on June 19, 1991. Choice-of-law rules are part of any jurisdiction's whole law, however, a principle important in diversity cases. See *Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941). Usually we do not think of federal courts as having choice-of-law rules for cases decided under federal law, which is supposed to be uniform. Yet there is one distinctively federal choice-of-law problem. What happens when a federal court transfers the case to another under §1404(a)? *Van Dusen v. Barrack*, 376 U.S. 612 (1964), and *Ferens v. John Deere Co.*, 494 U.S. 516 (1990), hold that such a transfer leaves the law unaffected; the original forum's rules (including the choice-of-law rules of the state in which that court sits) are unaffected by the movement.

Are different circuits like different states for the purposes of *Van Dusen* and *Ferens*? Usually not. *In re Korean Air Lines Disaster*, 829 F.2d 1171 (D.C. Cir. 1987) (Ruth B. Ginsburg, J.), affirmed on other grounds under the name *Chan v. Korean Air Lines, Ltd.*, 490 U.S. 122 (1989). A

single federal law implies a national interpretation. Although courts of appeals cannot achieve this on their own, the norm is that each court of appeals considers the question independently and reaches its own decision, without regard to the geographic location of the events giving rise to the litigation. This meant to the judges in *Korean Air Lines* that a transfer under §1404(a) leaves each court to work out the problem for itself rather than to guess how the circuit comprising the original district court would reason. Congress might require one federal court to apply another's interpretation of federal law, but §1404(a) does not itself do so. *Id.* at 1178 (D.H. Ginsburg, J., concurring). See also Richard L. Marcus, *Conflicts Among Circuits and Transfers Within the Federal Judicial System*, 93 Yale L.J. 677, 702 (1984).

We agree with *Korean Air Lines* that a transferee court normally should use its own best judgment about the meaning of federal law when evaluating a federal claim, but §27A instructs us to act differently. Section 27A recognizes that different circuits had taken different approaches to the appropriate statute of limitations in suits under §10(b), and it codifies this fractured nature of federal law for cases filed before June 20, 1991. Congress requires us to apply federal law as courts understood it at a point in the past rather than to make an independent judgment about what that law actually is. And the law in use on June 19, 1991, was not nationally uniform. By then three circuits had adopted §13 of the '33 Act for suits under §10(b). One applied this rule retroactively, another prospectively (in the main), and this circuit had not ruled on retroactivity. In all other circuits the courts derived the period of limitations from state law—with different circuits looking to different kinds of state laws. See *Pommer v. Medtest Corp.*, 961 F.2d 620, 627-28 (7th Cir. 1992); *Norris v. Wirtz*, 818 F.2d 1329, 1331-33 (7th Cir. 1987).

Recently the second circuit concluded that because "federal law (unlike state law) is supposed to be unitary", a transferee court should apply the law of its circuit and ignore the law of the transferor court when determining

"the jurisdiction" under §27A. *Menowitz v. Brown*, 991 F.2d 36, 40 (2d Cir. 1993). *Menowitz* held that *Van Dusen* and *Ferens* apply only in diversity cases. We believe that this conclusion disregards both the language of §27A (whose reference to "the jurisdiction" implies a *non*-uniform federal law) and the holdings of *Van Dusen* and *Ferens*, which construed §1404(a) rather than any principle of state law. Although both of those cases arose under the diversity jurisdiction, their references to *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), do not imply a ruling limited to state law. *Erie* is itself part of national law, interpreting the Rules of Decision Act, 28 U.S.C. §1652. *Van Dusen* and *Ferens* accordingly apply whenever different federal courts properly use different rules. *Erie* is not unique in requiring federal courts to apply disparate norms. Consider 42 U.S.C. §1988, which leads federal courts to use state law as the basis of a federal period of limitations. *Wilson v. Garcia*, 471 U.S. 261 (1985); *Owens v. Okure*, 488 U.S. 235 (1989). Or consider the law of federal contracts, which is largely borrowed from state law. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979); *United States v. Einum*, 992 F.2d 761 (7th Cir. 1993). When the law of the United States is geographically non-uniform, a transferee court should use the rule of the transferor forum in order to implement the central conclusion of *Van Dusen* and *Ferens*: that a transfer under §1404(a) accomplishes "but a change of courtrooms". *Van Dusen*, 376 U.S. at 639. Section 27A presents such a situation. Accordingly we respectfully disagree with *Menowitz*.†

So we must examine how a judge in the Central District of California would have viewed the limitations question on June 19, 1991. At the time, courts within the ninth circuit used the most analogous statute of limitations under the law of the state in which the district court sat.

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† Because this opinion creates a conflict among the circuits, it was circulated before release to all judges in active service. Circuit Rule 40(f). None favored a hearing in banc.

Stitt v. Williams, 919 F.2d 516, 522 (9th Cir. 1990). California's three year statute of limitations for fraud, Cal. Civ. Proc. Code §338, was the appropriate one to use in securities fraud cases. *Ibid.* The period under that statute "commences when the plaintiff discovered or could have discovered the fraud with the exercise of reasonable diligence". *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1309 (9th Cir. 1982). See also *Miller v. Bechtel Corp.*, 33 Cal. 3d 868, 875, 663 P.2d 177, 181 (1983); *Mosesian v. Peat, Marwick, Mitchell & Co.*, 727 F.2d 873, 877 (9th Cir. 1984).

The district court concluded that the Eckstein plaintiffs' claim would be barred by that rule as well as the federal rule adopted in *Short*. It concluded that the time for bringing suit started to run when the investors purchased their limited partnership interests because the dire warnings of risk in the prospectus should have put the investors on notice of fraud. 786 F. Supp. at 1466. This logic is flawed. A warning about risk does not give notice of fraud. Every prospectus is filled with advice about the perils of the business, because every business faces its own set of risks. Giving general advice about the industry does not relieve an issuer of the need to be truthful about itself. Warnings of the kind that appeared in BFI's prospectus put investors on notice that there is a chance things may not go as hoped *in the future*; they do not put investors on notice that statements made in the prospectus are untrue *at the time*, or that important facts have been left out of the prospectus. Plaintiffs allege, for example, that New World and Worldvision had come to blows, and that this gravely affected the opportunity for profitable investment. A prospectus stating a risk that such a thing *could* happen is a far cry from one stating that this *had* happened. The former does not put an investor on notice of the latter.

Plaintiffs' argument that they "could [not] have discovered the fraud with the exercise of reasonable diligence" until Balcor told them in 1988 they probably would lose money is equally flawed. Discovering that one has lost money is not the same as discovering that one has been defrauded. Most losses occur without fraud of any kind.

DiLeo v. Ernst & Young, 901 F.2d 624, 627-28 (7th Cir. 1990). And victims of fraud usually discover the problem long before the wrongdoer stands up and confesses. Plaintiffs' position amounts to an assertion that the time to sue does not start until the extent of the injury becomes clear. But the question under California law is when the investors discovered (or should have discovered) the deceit, not when the full consequences of that deceit are felt. An investor can be defrauded before any loss is realized. Discovery of the fraud means the discovery of the misrepresentation. *Howard v. Haddad*, 962 F.2d 328, 330 (4th Cir. 1992); *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406, 1412-13 (9th Cir. 1987). Investors must bring their claims as soon as they become aware of misrepresentations or omissions, instead of waiting "while avoidable damages accrue." *Volk*, 816 F.2d at 1412.

It is conceivable, we suppose, that until receiving the advice in mid-1988 reasonable investors would not have bestirred themselves to find out about New World. (The Eckstein plaintiffs, after all, invested in BFI without reading the prospectus; apparently they do not think information very useful.) Many reasonable investors—the kind who read the prospectus?—would have pricked up their ears sooner. The fact that Worldvision filed suit against New World in the fall of 1985 to rescind its contract may have been sufficient to trigger an investigation. The suit itself was a piece of information missing from the prospectus; from one angle its omission *was* the fraud, yet the fact of the suit was public knowledge in 1985. If that should have triggered an investigation, then California's statute of limitations expired before the Eckstein plaintiffs filed their suit in February 1989. That plaintiffs may have been ignorant of Worldvision's suit should not matter, because they, not the defendants, bear the burden of their own ignorance. See *United States v. Kubrick*, 444 U.S. 111, 124 (1979); *Norris*, 818 F.2d at 1335-36. It may be possible to decide what reasonable investors knew, or should have known, without submitting the question to a jury, but the subject is one for the district court to address in the first instance.

B

Unlike the Eckstein plaintiffs, the Majeski plaintiffs have clearly satisfied the relevant state statute of limitations. Wisconsin gives investors three years from the sale, Wis. Stat. §551.59, and the Majeski plaintiffs filed before the end of 1988, at a time when we would have used that law as the period of limitations. *Cahill v. Ernst & Ernst*, 625 F.2d 151 (7th Cir. 1980). But §13 of the '33 Act gives investors only one year from the time the fraud was or should have been discovered, and the considerations we discussed immediately above imply that the Majeski plaintiffs would have a hard time satisfying that requirement. The district court held that §13 applies to the Majeski plaintiffs because they filed suit within the seventh circuit after *Short* had been decided, and that the suit is untimely under §13.

The district court concluded that *Short* is fully retroactive. Under current law, it would be. *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), holds that decisions are retroactive if the court applies the new rule to the parties. See also *Harper v. Virginia Department of Taxation*, 61 U.S.L.W. 4664 (U.S. June 18, 1993). *Short* applied its new rule to the litigants in that case. But §27A tells us to use the law, including principles of retroactivity, in force on June 19, 1991, and *Beam*, like *Lampf*, was decided on June 20, 1991. We concluded in *McCool v. Strata Oil Co.*, 972 F.2d 1452, 1458-59 (7th Cir. 1992), that *Beam* changed the law of retroactivity, which means that on June 19, 1991, *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), still controlled the approach to that subject. *McCool* holds that §27A requires us to employ *Chevron*'s approach. To apply *Chevron* courts must balance several factors. After a consideration of these factors *McCool* concluded that *Short* does not apply retroactively when the plaintiff relied on the pre-*Short* limitations period. 972 F.2d at 1459.

The dispositive question under *McCool* thus is: if the plaintiffs had known that *Short* would apply to their claim,

could and would they have filed within the period of limitations? The Majeski plaintiffs say that they filed suit within two months of discovering the fraud, so it is hard to see how any delay can be chalked up to reliance on the availability of Wisconsin's law. But the belief that state law would provide three years may have influenced the investors in other ways. Perhaps it offered assurance that they need not investigate expeditiously. Perhaps the Majeski plaintiffs relied by filing in Wisconsin when they could have chosen California. Although Balcor insists that filing in one forum as opposed to another is not a legitimate form of reliance, we disagree. *McCool* held that the plaintiffs had relied on the former status of the law by dismissing a suit they had filed in state court. 972 F.2d at 1459. We do not believe that relying by foregoing the opportunity to pursue a claim in a state forum should differ from foregoing the opportunity to pursue a claim in another federal forum.

Ultimately, the determination whether the plaintiffs did rely is for the district court. *Chevron* creates a balancing approach, and the court of first instance does the balancing with deferential appellate review. Indeed if material factual questions about reliance are controverted the matter cannot be decided on summary judgment at all. *Berning v. A.G. Edwards & Sons, Inc.*, 990 F.2d 272, 276-77 (7th Cir. 1993).

III

Despite our disagreement with the district court's reason for dismissing the suits, a remand does not necessarily follow. We may affirm its judgment on any properly preserved ground that the record supports. *Massachusetts Mutual Life Insurance Co. v. Ludwig*, 426 U.S. 479 (1976). A timely but non-meritorious suit should be cut off at the first opportunity. We therefore inquire whether the plaintiffs have a good claim under the securities laws.

A

Because they never read the prospectus, the Eckstein plaintiffs encounter difficulty in establishing that they relied to their detriment on the seller's statements, a component of a claim under §10(b) and Rule 10b-5 according to the canonical formulation. See *List v. Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965). Although courts often refer to "reliance" as an element of the claim under §10(b), we have held that reliance is a *means* by which the plaintiff may establish that material misstatements or omissions caused him injury, rather than an indispensable element. *Flamm v. Eberstadt*, 814 F.2d 1169, 1173 (7th Cir. 1987). See also *Rowe v. Maremont Corp.*, 850 F.2d 1226, 1233 (7th Cir. 1988). The Supreme Court's adoption of the fraud-on-the-market doctrine in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), shows that reliance is not essential; although *Basic* continued to use that word, it allowed an alternative method of establishing causation—an effect on the market price—to support recovery by investors who never read the supposedly deceitful statement. *Id.* at 243-47. See also *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-54 (1972).

When "the market"—that is, the outcome of trading by persons who are well-informed about what the issuer is doing and saying—translates a lie or omission from voice to price, it is easy to see how injury can befall a person who is unaware of the deceit. The price in an open and developed market usually reflects all available information, because the price is an outcome of competition among knowledgeable investors. See generally Sanford J. Grossman, *The Informational Role of Prices* (1989); James H. Lorie, Peter Dodd & Mary Hamilton Kimpton, *The Stock Market: Theories and Evidence* (2d ed. 1985). Competition among savvy investors leads to a price that impounds all available information, even knowledge that is difficult to articulate. We call a market "efficient" because the price reflects a consensus about the value of the security being traded—not necessarily because the price captures the true value of the firm's assets but because the price is

the best available device to assess the significance of additional bits of information. Investors who trade at the market price are affected, for good or ill, by the information underlying that price.

Not all stocks are eagerly followed by astute investors with the capital to turn their views into movements in price. The more thinly traded the stock, the less well the price reflects the latest pieces of information. "Efficiency" is not an all-or-nothing phenomenon. See Comment, *Sufficient Efficiency: Fraud on the Market in the Initial Public Offering Context*, 58 U. Chi. L. Rev. 1393 (1991). Prices of even poorly followed stocks change in response to news, including statements by the issuers, and these changes may be better indicators of causation than litigants' self-serving statements about what they read and relied on and about what they would have paid (or whether they would have bought at all) had the issuer said something different. Even an "inefficient" market price is objective and contemporaneous with events, not plagued by lapses of memory or the cognitive dissonance that influences what witnesses may remember years later. Still, at some point the market process peters out and the litigation process offers superior information about causation. The Eckstein plaintiffs may have reached that point.

BFI issued its interests as part of an initial public offering at a fixed price, $1,000 per unit (with a minimum of three units per investor). No trading market valued these interests; only the investors could do so. No trading market developed afterward, so we cannot combine the Capital Asset Pricing Model with the tables in the Wall Street Journal to see what effect Worldvision's suit, or the other information that slowly came to light about New World, had on price. It would be revealing if news about Worldvision's withdrawal as New World's distributor caused the price to fall by 20% (using the CAPM to hold the market constant). It would be equally revealing if the news had no effect on price, which would imply either that other distributors were readily available (so that information about Worldvision was not material) or that investors had

fully taken this fact into account back in 1985 (so the statute of limitations would bar these suits). Alas, no such luck, because there are no such prices. This does not mean that the Eckstein plaintiffs cannot show causation, but they must carry the greater burden of proving the causal links that an efficient secondary market establishes automatically.

The Eckstein plaintiffs try to do so via a theory we could call "fraud-created-the-market." BFI's offering was conditioned on its ability to raise at least $35 million. A minimum sales requirement may serve two functions: it ensures that the venture has sufficient capital to function, and it provides a form of vicarious protection to ignorant investors who assume that the condition will be met only if a significant number of informed buyers think the project a good investment. Plaintiffs allege that, if BFI had made complete and truthful statements, it would not have been able to sell interests to investors who did read the prospectus. Without those investors, BFI would not have been able to sell the minimum amount, and thus would have returned the plaintiffs' tendered funds. Thus, say the Eckstein plaintiffs, the misstatements and omissions in the prospectus caused their losses.

The fifth circuit adopted a variant of this approach by a vote of 12 to 10 in *Shores v. Sklar*, 647 F.2d 462 (1981) (in banc). *Shores* held that an investor may maintain an action under §10(b) by establishing that the fraud permitted the securities to *exist* in the market—that but for the fraud the securities would have been "unmarketable"—and that the investor relied on their existence. The tenth and eleventh circuits follow modified versions of the *Shores* approach, while the sixth circuit has repudiated that case outright. Compare *T.J. Raney & Sons, Inc. v. Ft. Cobb Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330 (10th Cir. 1983), and *Ross v. Bank South, N.A.*, 885 F.2d 723 (11th Cir. 1989) (in banc), with *Freeman v. Laventhol & Horwath*, 915 F.2d 193 (6th Cir. 1990). We agree with the sixth circuit. The *existence* of a security does not depend

on, or warrant, the adequacy of disclosure. Many a security is on the market even though the issuer or some third party made incomplete disclosures. Federal securities law does not include "merit regulation." See *The Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990); §23 of the '33 Act, 15 U.S.C. §77w. Full disclosure of adverse information may lower the price, but it does not exclude the security from the market. Securities of bankrupt corporations trade freely; some markets specialize in penny stocks. Thus the linchpin of *Shores*—that disclosing bad information keeps securities off the market, entitling investors to rely on the presence of the securities just as they would rely on statements in a prospectus—is simply false.

Without the aid of *Shores*, the Eckstein plaintiffs have rough sledding ahead. They cannot use the incomplete or rosy nature of Balcor's pamphlets, which they may have read, as the actionable "fraud"; sales literature need not repeat the full disclosures and risk analysis in the prospectus. (We discuss this more fully below.) To prevail the Eckstein plaintiffs must prove that, had the prospectus been free from fraud, BFI would not have satisfied the minimum-sale requirement of $35 million. Because this is a suit under §10(b) of the '34 Act rather than §§ 11 or 12(2) of the '33 Act, the Eckstein plaintiffs must establish this counterfactual proposition about the decisionmaking of thousands of investors using only statements or omissions amounting to fraud; other errors and omissions that might have supported liability under §§ 11 or 12(2) do not support an inference of causation that can replace direct reliance in a case under §10(b). The difference between errors and fraud, and the fact that BFI attracted $48 million, substantially exceeding the $35 million cutoff, present the Eckstein plaintiffs with a daunting task. Still, the record in its current state does not doom their case, so we must remand their case to the district court for further proceedings.

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The Majeski plaintiffs, who read the prospectus, may establish causation in the traditional way, by proof of their reliance on any misstatements and omissions. These plaintiffs advance a second theory—that because Balcor circulated upbeat brochures and other supplemental literature that was much easier to understand than the dense prospectus, the defendants should have put the stern warnings about risk in these documents as well. Why, one of these brochures even offered tables of possible rates of return under different assumptions, and the worst case still showed BFI able to repay the original investments (although without interest or other profits). Because these easy-to-digest brochures dominated the investors' perception of the risks, plaintiffs insist, Balcor was obligated to make additional disclosures of risk in the supplemental literature. To simplify the conduct of this litigation on remand, we now hold that such a theory cannot support a claim under §10(b)—which, recall, depends on proof of fraud, and not just errors or omissions. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Aaron v. SEC*, 446 U.S. 680 (1980).

The '33 Act permits issuers, underwriters, and dealers to engage in "free writing" once the registration statement becomes effective, and to furnish promotional literature to investors provided that literature is accompanied or preceded by a prospectus. Section 2(10)(a) of the '33 Act, 15 U.S.C. §77b(10)(a); Louis Loss, *Fundamentals of Securities Regulation* 119 (1983). Only the registration statement need be self-contained. A prospectus is a subset of the information contained in the registration statement, and the sales brochures are a subset of the information in the prospectus (plus the customary effort to *sell* the securities). If the sales literature had to contain all the warnings that appear in the prospectus, the privilege of distributing supplemental sales literature would be all but meaningless. Federal law establishes a regime in which the prospectus contains the comprehensive description of

the securities. Other literature can be brief precisely because an inquiring investor has the prospectus to turn to. Federal law also establishes a rule for resolving conflicts: in the event statements in sales brochures and the prospectus do not agree, the prospectus wins. See *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1033 (2d Cir. 1993). "If the investor already possesses information sufficient to call [a] representation into question, he cannot claim later that he relied on or was deceived by the lie." *Teamsters Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522, 530 (7th Cir. 1985). See also, e.g., *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1030-31 (9th Cir. 1992); *Zobrist v. Coal-X, Inc.*, 708 F.2d 1511, 1518-19 (10th Cir. 1983). The Majeski plaintiffs do not contend that the risk disclosures in the prospectus were buried or indigestible; to the contrary, they were prominent and blunt. Cf. *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2760-61 (1991); *Associated Randall Bank v. Griffin, Kubik, Stephens & Thompson, Inc.*, No. 92-2684 (7th Cir. Aug. 19, 1993); *Acme Propane, Inc. v. Tenexco, Inc.*, 844 F.2d 1317, 1322, 1325 (7th Cir. 1988). Failure to disclose important things in supplemental literature is not fraud when those things appear in the prospectus.

One final observation. Many of the claims in this case arise out of predictions that did not come to pass. For example, the Majeski plaintiffs allege that Balcor stated that presales of movies would generate revenues equal to half of the movies' production costs, and that this statement is false. Yet the statement is nothing but a prediction about how much revenue New World expected to generate from preselling movies. Only statements or omissions of fact can be fraudulent. Although intentions and beliefs are "facts" for this purpose when they are open to objective verification, *Sandberg*, 111 S. Ct. at 2760, 2765, an inability to foresee the future does not constitute fraud, because "[t]he securities laws approach matters from an *ex ante* perspective". *Pommer*, 961 F.2d at 623. See *DiLeo*, 901 F.2d at 627-28. If those statements had a reasonable basis when made, the defendants did not com-

mit fraud. *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 513 (7th Cir. 1989).

The judgments are vacated, and the cases are remanded for further proceedings consistent with this opinion. As the district court dismissed the plaintiffs' claims under state law only because it had dismissed all of their claims under federal law, the state-law claims must be reinstated.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT - WITH ORAL ARGUMENT

Date: August 20, 1993

BEFORE: Honorable Walter J. Cummings, Circuit Judge
Honorable John L. Coffey, Circuit Judge
Honorable Frank H. Easterbrook, Circuit Judge

Nos. 92-1851 and 92-2510

ROBERT ECKSTEIN, et al.,

Plaintiffs - Appellants

v.

BALCOR FILM INVESTORS, BALCOR ENTERTAINMENT COMPANY, BALCOR COMPANY, et. al.,

Defendants - Appellees

Appeal from the United States District Court for the
Eastern District of Wisconsin
No. 88 C 1079, John W. Reynolds, Senior Judge

This cause was heard on the record from the above mentioned District Court, and was argued by counsel.

On consideration whereof, **IT IS ORDERED AND ADJUDGED** by this court that the judgment of the District Court is VACATED and the case is REMANDED, in accordance with the decision of this court entered this date. Appellants shall recover their costs.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

RALPH MAJESKI, JOSEPH YACH, JANICE WAISMAN, LARRY R. PETERSON, THOMAS WEIL, LEE ALDRIDGE, RANDY KARPINSKY, KENNETH KULAS ROBB S. ELLIOTT and RAYMOND HARDING,

Plaintiffs,

v. Civil Action No. 88-C-1079

BALCOR ENTERTAINMENT COMPANY LTD, an Illinois corporation; SHEARSON LEHMAN HUTTON, INC., f/k/a SHEARSON LEHMAN BROTHERS, INC., and f/k/a SHEARSON LEHMAN/AMERICAN EXPRESS, INC., a Delaware corporation; THE BALCOR COMPANY, an Illinois corporation; BALCOR/AMERICAN EXPRESS INC., an Illinois corporation; BALCOR SECURITIES COMPANY, an Illinois corporation, THE AMERICAN EXPRESS COMPANY, a New York corporation; NEW WORLD PICTURES, LTD., a California corporation, and BALCOR FILM INVESTORS, an Illinois Limited Partnership,

Defendants.

ROBERT ECKSTEIN and SYLVIA ECKSTEIN, on behalf of themselves and all others similarly situated,

Plaintiffs,

v. Civil Action No. 89-C-1315

BALCOR FILM INVESTORS, BALCOR ENTERTAINMENT COMPANY, THE BALCOR COMPANY, THE BALCOR SECURITIES COMPANY, JERRY M. REINSDORF, ROBERT A. JUDELSON, JAMES E. FINLEY, GREGORY S. JUNKIN, BARRY R. JACKSON, JOSEPH A. KRUSZYNSKI, NEW WORLD ENTERTAINMENT, LTD., LAWRENCE L. KUPPIN, ROBERT REHME, and HARRY E. SLOAN,

Defendants.

DECISION AND ORDER

INTRODUCTION

This action concerns a public offering of limited partnership interests in Balcor Film Investors ("BFI"). BFI was formed to produce and distribute movies pursuant to an agreement with a motion picture company, New World Entertainment, Ltd. ("New World"). The initial offering was unsuccessful, and the Securities Exchange Commission required that the purchases of BFI interests be cancelled. On October 11, 1985, the prospectus was amended to make a second offering and to seek resubscription by previous investors. The interests were sold between October 11, 1985, and December 31, 1985. Both the Majeski and Eckstein classes[1] allege that the defendants violated § 10(b) of

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[1] On August 23, 1989, the Judicial Panel on Multidistrict Litigation ordered, pursuant to Title 28 U.S.C. § 1407, that the case Robert Eckstein, et al. v. Balcor Film Investors, et al. ("Eckstein") (continued...)

the Securities Exchange Act of 1934 and Rule 10b-5 by portraying the BFI investment as "safe and conservative." This court concludes, as discussed below, that the defendants adequately conveyed the risky nature of the BFI investment.

Presently before the court is the defendants' November 5, 1991 motion for partial summary judgment on all remaining federal claims in both Majeski and Eckstein. This court previously dismissed the Majeski class claims that the defendants violated §§ 17(a) and 12(2) of the Securities Act of 1933. The only additional federal claim alleged by the Majeski class is that the defendants violated § 10(b) and Rule 10b-5. The Eckstein class only alleges violations of § 10(b) and Rule 10b-5 in its complaint. The defendants argue that the federal securities law claims under § 10(b) and Rule 10b-5 alleged in both Majeski and Eckstein are barred by the statute of limitations in light of a recent Supreme Court decision, Lampf, Pleva, Lipkind, Prupis & Petrigrow v. Gilbertson, 111 S. Ct. 2773 (1991) ("Lampf").

In "Lampf", the Supreme Court established a uniform statute of limitations for Section 10(b) claims that "[l]itigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced within one year after the discovery of the facts constituting the viola-

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[1] (...continued)
be transferred from the Central District of California to this court for consolidated pretrial proceedings with Ralph Majeski, et al. v. Balcor Film Investors, et al. ("Majeski"). On February 27, 1991, this court permanently transferred, pursuant to Title 28 U.S.C. § 1404(a), Eckstein to this court. This court also consolidated Majeski and Eckstein for pretrial and trial purposes.

tion and within three years after such violation." Lampf at 2782 (footnote omitted). The Supreme Court applied this rule retroactively.

On December 20, 1991, the President signed Senate Bill 543 into law, which essentially overruled Lampf. The new law states that:

> The limitation period for any private civil action implied under section 10(b) of this Act that was commenced on or before June 19, 1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991.

Federal Deposit Insurance Corporation Improvement Act of 1991, Public L. No. 102-242, § 476, 105 Statutes 2236, 2387 (1991).

The defendants argue that the Majeski and Eckstein classes knew or should have known of their claim in 1985 when they received the BFI prospectus, which contained high risk disclosures; these high risk disclosures would have been in conflict with the "safe and conservative" investment portrayal which the plaintiffs allege the defendants made. Because the last possible day of sale for BFI investments and of receipt of the prospectus was December 31, 1985, any claim accruing at this time had to be filed by December 31, 1988, to meet the three-year prong of the statute of limitations, as this court discusses below. Alternatively, the defendants argue that the plaintiffs knew or should have known of their claim no later than May 14, 1987, when the plaintiffs received a report that BFI had produced all its films, and had a net loss of

$14 million. Any claim accruing at this time had to be filed by May 14, 1988, to meet the one-year prong of the statute of limitations, as this court discusses below.

ANALYSIS

Rule 56(c) of the Federal Rules of Civil Procedure provides that a federal district court shall grant a motion for summary judgment if the pleadings, depositions, answers to interrogatories, admissions, and affidavits indicate that no material facts are in dispute and that the moving party is entitled to judgment as a matter of law. Howland v. Kilquist, 833 F.2d 639, 642 (7th Cir. 1987). The party moving the court for summary judgment has the burden of proving that no material facts are in dispute, and the court must review the record with all reasonable inferences being drawn in favor of the non-moving party. Becker v. Tenenbaum-Hill Associates, Inc., 914 F.2d 107, 110 (7th Cir. 1990); Reardon v. Wroan, 811 F.2d 1025, 1027 (7th Cir. 1987).

Applicable Law

The Eckstein class argues that since its complaint was originally filed on February 10, 1989, in the Ninth Circuit, the Ninth Circuit's statute of limitations should be applied. California Code of Civil Procedure § 388(4), which the Ninth Circuit has borrowed for 10(b) purposes, allows actions filed within three years of discovery of the facts constituting fraud.

The defendants argue that the new law mandates that "the jurisdiction" is the Seventh Circuit. This

court agrees with the defendants; the Seventh Circuit was "the jurisdiction" for this action as of June 19, 1991. Additionally, this court's earlier analysis and conclusion that Seventh Circuit law applies to the Eckstein class is still applicable. See Eckstein v. Balcor Film Investors, 740 F. Supp. 572 (E.D. Wis. 1990). Thus, the Seventh Circuit law as it existed on June 19, 1991 applies.

The relevant Seventh Circuit case is Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385 (7th Cir. 1990), cert. den., 111 S. Ct. 2887 (1991) ("Short"). In Short, the Seventh Circuit decided to change its practice of consulting state blue sky statutes to determine the statute of limitations for actions brought under § 10(b) and Rule 10b-5. The court held that § 13 of the Securities Act of 1933 is the controlling statute of limitations for actions under § 10(b) and Rule 10b-5. Id. at 1389. That statute provides:

> No action shall be maintained to enforce any liability . . . unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . . In no event shall any such action be brought to enforce a liability created . . . more than three years after the sale.

Short at 1390. In Short, the Seventh Circuit applied this statute of limitations to the plaintiff in that case. The Seventh Circuit specifically declined to determine whether its decision should be applied retroactively to other actions.

All the parties in this action discuss Chevron Oil v. Huson, 404 U.S. 97 (1971), in which the Supreme Court established three factors to consider when determining whether newly-created court law should be applied retroactively: (1) whether the decision "establish[es] a new principle of law, either by overruling clear past precedent on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed" (citations omitted); (2) "whether [the] retrospective operation will further or retard its [the new rule's] operation" (citation omitted); and (3) whether the retroactive application "could produce substantial inequitable results" (citation omitted). Id. at 106-107.

While the Seventh Circuit has not yet addressed the issue of whether the Short decision should be applied retroactively, this court has applied Short retroactively when no reliance on the formerly applicable statute of limitations has been shown. See Wentzka v. Gellman, 759 F. Supp. 484, 487 (E.D. Wis. 1991).

In a recent decision, the Supreme Court greatly reduced, if not abolished, the impact of Chevron Oil when it held that "it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so." See James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439, 2446 (June 20, 1991) ("Beam"). This decision was made one day after the June 19, 1991 date established by the new law. Beam clarifies, but does not create new law. Thus, the then existing law in the Seventh Circuit must be applied, which means that Beam directs this court to apply the rule adopted by the Seventh Circuit in Short to this action.

This court notes that the policy reasons for a uniform statute of limitations are great. See, e.g., Short at 1388-1389. Those policy considerations are even stronger in a case such as this, where a class action involves a number of people from different states.

Majeski

It is clear that the Majeski complaint, filed on October 11, 1988, was timely filed with respect to the three-year prong of the applicable statute of limitations. The defendants argue that the Majeski class filed its complaint more that one year after it knew or should have known of the facts supporting its alleged claim, which brings us to the question of whether the prospectus and its accompanying reports did or should have put the plaintiffs of notice of their claims.

In support of their proposition, the defendants argue that the investors were repeatedly warned of the risky nature of the BFI investment, beginning with the prospectus and then repeated in the annual reports.[2] The prospectus itself contained badges of riskiness. The following quotes list some of these badges, with this court's emphasis.

> THIS OFFERING INVOLVES CERTAIN RISK FACTORS. In this regard, investors should consider that:

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[2] The court has attached a chart to this opinion to aid the reader in following the progression of events relevant to this action.

(1) Interests are being offered only to persons who meet the suitability standards set forth in this Prospectus. See "Who Should Invest." . . .

. . .

(4) The success of a motion picture is largely dependent upon public taste, which cannot be accurately anticipated, and other factors beyond the control of the General Partner. Accordingly, it is impossible for anyone to predict with a high degree of certainty whether any particular picture or group of pictures will be financially successful. See "Risk Factors--The Motion Picture Industry Generally."

For further discussion of risks of the offering, see "Risk Factors."

Jan. 8, 1985 BFI Prospectus at 1 (emphasis added).[3]

An investment in the Partnership involves a high degree of risk. . . . Accordingly, Interests will be sold only to a person who represents in writing that he has adequate means of providing for his current needs and personal contingencies and no need for liquidity of this investment . . . .

Id. at 2 (Who Should Invest) (emphasis added).

The production, distribution and exploitation of motion pictures is a complex and risky undertaking and there can be no assurance that the Partnership's investment objectives will be realized in whole or in part.

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[3] A copy of the prospectus can be found attached as Ex. H to the defendants' motion.

Id. at 4 (Partnership Investment Objectives) (emphasis added).

> The following briefly summarizes certain significant risks relating to an investment in the Partnership. These risks are more completely discussed in the "Risk Factors" section of this Prospectus and in the other sections of this Prospectus referred to therein. The following summary is qualified in its entirety by reference to such "Risk Factors" section and to the other sections of this Prospectus cited therein.
>
> --An investment in the Partnership is subject to all of the risks associated with the motion picture industry. The success of any motion picture is largely dependent upon public taste, which cannot be accurately anticipated. In addition, the success of a motion picture is dependent upon several factors, including local promotion, the cooperation and acceptance of exhibitors and the popularity of other motion pictures being distributed at the time a picture is released. The motion picture industry is highly competitive and Partnership Pictures will be competing with pictures from many sources, including pictures produced and distributed by companies which are better capitalized and better established in the motion picture industry than are the Partnership and New World.
>
> --The Partnership's arrangements with New World reserve for New World a substantial amount of discretion with respect to several significant factors relating to the development,

acquisition, production and distribution of Partnership pictures. The Partnership will be largely dependent upon the performance by New World of its obligations under the Production Agreement, including New World's ability to identify motion picture projects with potential for commercial appeal, to product commercially viable pictures on budget and on schedule and to exploit such pictures successfully.

--The Partnership will also be dependent upon the overall financial performance of all aspects of New World's operations for the value of the Preferred Stock and to generate sufficient earnings (in excess of present earnings) to make interest and principal payments when due under the Note. Between accountings to the Partnership (monthly, for an initial period, and quarterly thereafter), amounts otherwise payable to the Partnership may be commingled with other funds belonging to New World or other parties. In the event of the insolvency of New World, the Partnership may be unable to receive payments from New World as and when they are due. In addition, the Partnership has agreed with New World and its principal lender to forego certain legal remedies which would otherwise be available to it under certain conditions.

--The Partnership intends to incur indebtedness in connection with the financing of Distribution Expenses. The cost of this borrowing may reduce profits or increase losses resulting from the operations of the Partnership.

--The General Partner will have sole responsibility for, and control of, all aspects of the Partnership's operations, and the Limited Partners will be entirely dependent upon the General Partner for the management of the Partnership's business. The Partnership is newly formed and has no operating history upon which to base an evaluation of investment in the Partnership.

--The General Partners and New World will be subject to various conflicts of interest in connection with the transactions provided for in the Production Agreement.

Id. at 6 (Risk Factors) (emphasis added).

An investment in the Partnership involves a high degree of risk and should only be considered by persons who can afford to lose their entire investment in the Partnership. In addition to the factors set forth elsewhere in the Prospectus (see "Description of Motion Picture Industry and New World Pictures" and "Business of the Partnership"), investors should carefully consider the following:

1. *The Motion Picture Industry in General.* The Partnership's activities are subject to all of the risks associated with the motion picture industry. Only a relatively small percentage of motion pictures released in the country generate sufficient receipts to return to producers their investment in pictures.

In view of the foregoing, it is impossible for anyone to predict whether any particular pic-

ture or group of pictures will be financially successful and there can be no assurance that the Partnership will recover its costs in connection with the production, acquisition and distribution of the Partnership Pictures.

2. *Developments in the Motion Picture Industry.* It is not possible to predict accurately the other effects that recent technological developments, and the developments that may occur in the future, may have on the value of rights in certain markets or media, the motion picture industry in general or on the ability of Partnership Pictures to generate revenues.

. . . .

10. *No Operating History.* The Partnership is newly formed and has no operating history upon which to base an evaluation of investment in the Partnership. The Partnership will be competing with companies which are better capitalized and better established in the motion picture industry.

Id. at 27-30 (Risk Factors) (emphasis added).

The defendants further argue that the annual reports did or should have put the Majeski class on notice that the BFI investment was not a conservative investment as the plaintiffs allege they were told:

> Based on New World's estimates of ultimate revenues from the 11 partnership pictures released through June 30, 1986, and the additional production and distribution costs the partnership has committed to pay relating to

> these pictures, the general partner does not believe the partnership will fully recover all of its investment in these pictures. . . .

Aug. 13, 1986 BFI Second Quarter 1986 Report to Investors and Interim Financial Statements at 1 (*Operations*) (emphasis added).[4]

> Based on estimates provided by New World regarding the ultimate revenues expected to be generated from all markets for the eleven films released through June 30, 1986, and the additional production and distribution costs to be paid, the Partnership does not believe it will recover its total investment in these films.

Id. at 8 (Management's Discussion and Analysis, *Operations*) (emphasis added).

> Based on estimates provided by New World regarding the ultimate revenues expected to be generated from all markets for the films released through September 30, 1986 [eighteen total], and the additional production and distribution costs to be paid, the Partnership does not believe it will recover its total investment in these films.

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[4] A copy of this report can be found attached as Ex. A to the defendants' motion. This court refers to the reports by the typewritten dates on the reports. Apparently, there was often a several month delay between the date and the mailing of the reports to the investors.

Nov. 13, 1986 BFI Third Quarter 1986 Interim Financial Statements at 8 (Management's Discussion and Analysis, *Operations*) (emphasis added).[5]

> Based on estimates regarding the ultimate revenues expected to be generated from all markets for the films released through December 31, 1986 [nineteen total], and the additional production and distribution costs to be paid, the Partnership does not believe it will recover its total investment in these films.

Apr. 6, 1987 BFI 1986 Annual Report at 2 (Management's Discussion and Analysis of Financial Condition and Results of Operations, *Operations*) (emphasis added).[6]

> All of the Partnership's twenty-three motion pictures were released as of March 31, 1987 and are generating cash receipts from domestic and foreign theatrical exploitation, domestic and foreign home video, pay television and domestic television . . . . Based on estimates regarding the ultimate revenues expected to be generated from all markets for the films released through March 31, 1987 and the additional distribution costs to be paid, the Partnership does not believe it will recover its total investment in these films. . . . The estimated ultimate revenues for the films as of March

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[5] A copy of this report can be found attached as Ex. B to the defendants' motion.

[6] A copy of this report can be found attached as Ex. C to the defendants' motion.

> 31, 1987 total approximately $90,885,000 and the ultimate production and distribution costs total approximately $105,236,000, thus resulting in an overall net loss of approximately $14,351,000, all of which has been recognized through March 31, 1987.

May 14, 1987 BFI First Quarter 1987 Interim Financial Statement at 6 (Management's Discussion and Analysis, *Operations*) (emphasis added).[7]

> All of the Partnership's twenty-three motion pictures were released as of June 30, 1987 and are generating cash receipts from domestic and foreign theatrical exploitation, domestic and foreign home video, pay television and domestic television. . . . Based on estimates regarding the ultimate revenues expected to be generated from all markets for the films released through June 30, 1987 and the additional distribution costs to be paid, the Partnership does not believe it will recover its total investment in these films. . . . The estimated ultimate revenues for the films as of June 30, 1987 total approximately $87,000,000 and the ultimate production and distribution costs total approximately $104,482,000, thus resulting in an overall net loss of approximately $16,982,000.

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[7] A copy of this report can be found attached as Ex. D to the defendants' motion. This report was mailed to the investors in August 1987 (Jan. 6, 1992 Cody Aff. ¶¶ 3-4).

Aug. 18, 1987 BFI Second Quarter 1987 Interim Financial Statement at 7 (Management's Discussion and Analysis, *Operations*) (emphasis added).[8]

The Majeski class argues that supplemental literature portrayed the BFI investment as "safe" and "conservative," and that "[t]he 'worst case scenario' for this investment was a return of capital. A probable scenario would involve a doubling of money and a best case scenario was described as 'who knows.' " Dec. 20, 1991 Br. at 28; see also Feb. 24, 1989 Am. Compl. ¶ 12. The class further argues that "[t]he investors were entitled to assume that the Prospectus contained truthful information . . . the investors believed they were relying on information [contained in the supplemental literature] consistent with the Prospectus." Id. at 29-30.[9] Additionally, the reports were "not inconsistent with the offering literature, which had told investors some movies may be losers but that modest success by a few, or even by one movie, would make the overall venture profitable, potentially very profitable, and that the income from a variety of sources for

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[8] A copy of this report can be found attached as Ex. E to the defendant's motion.

[9] The Majeski class emphasizes the following language from the prospectus: "Although the information contained in such [supplemental] literature does not conflict with any of the information contained in this Prospectus . . . ." Jan. 8, 1985 BFI Prospectus at 69 (Supplemental Literature). That sentence continues: "such material does not purport to be complete, and should not be considered as a part of this Prospectus . . . or as incorporated in this Prospectus . . . or as forming the basis of the offering of the Interests described herein." Id.

BFI would nevertheless produce a successful investment." Id. at 5.

The Majeski class asserts that the first time the class members were made aware of any fraudulent actions was in May-July 1988, when the investors were told: "Based upon the performance of the Partnership's films to date, as well as New World's estimates of ultimate revenues from exploitation of the pictures and related expenses, we do not anticipate receiving sufficient net revenues to return all of investors' original capital." May 13, 1988 BFI 1987 Annual Report (July 1988 Silverstein [Balcor Chairman and CEO] letter) at 1.[10] This discovery date would therefore defeat the defendants' argument that Majeski was not timely filed with respect to the one-year prong of the statute of limitations. The Majeski class argues that their position on discovery creates questions of fact as to whether the complaint was filed within one year after the violation was or should have been discovered.

The standard for determining when fraud should have been discovered, however, is an objective one: were there sufficient facts to put a reasonable person on inquiry notice of possible fraud. DeBruyne v. Equitable Life Assurance Soc'y. of the U.S., 920 F.2d 457, 466 (7th Cir. 1990); Hupp v. Gray, 500 F.2d 993, 997 (7th Cir. 1974). This question may be resolved on summary judgment. DeBruyne at 466.

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[10] A copy of this letter can be found attached as Ex. L. to the Dec. 13, 1991 Kersten Aff.

This court finds that there were sufficient facts present in the prospectus itself, and supplemented by the numerous reports which discussed the losses associated with the released movies, to put the Majeski class on notice that the BFI investment was risky and not in conformance with the representations regarding the investments' returns which the class alleges were made. There were numerous warnings, conspicuously placed throughout the prospectus, that clearly and specifically discussed the risky nature of the BFI investment. The reports additionally told the investors that the movies were not bringing in money. These warnings, when viewed in light of the optimistic statements regarding the BFI investment that the class alleges were made, should have put a reasonable investor on notice that the BFI investment was not "safe and conservative." Thus, to meet the one-year prong of the statute of limitations, the Majeski complaint had to be filed by May 14, 1988.[11] Because the Majeski class knew or should have known of their alleged claim more than one year before the Majeski complaint was filed on October 11, 1988, the Majeski § 10(b) claim must be dismissed as untimely. Thus, the Majeski complaint has no remaining federal claims. The Majeski complaint also included a number of state law claims. On January 18, 1991, this court certified for class treatment the Majeski state law claim for breach of fiduciary duties. This court declined to certify for class treatment the Majeski state law claims of fraud, negligent misrepresentation, misrepresentation - strict

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[11] Or by August 1988, the last date by which all the plaintiffs received the BFI First Quarter 1987 Interim Financial Statement. See n.7, supra.

liability, breach of contract and derivative action. The dismissal of all the federal claims requires this court to relinquish its pendent claim jurisdiction and therefore dismiss this entire action. United Mine Workers v. Gibbs, 383 U.S. 715, 726 (1966).

The Majeski class also argues that they are not barred by the statute of limitations because the defendants actively concealed the fraud by lying about the relationship between BFI and New World, citing Davenport v. A.C. Davenport & Son Co., 903 F.2d 1139 (7th Cir. 1990) (overruled by Short regarding the statute of limitations). The class argues that the defendants failed to inform the investors that the Balcor defendants and New World were involved in serious disputes, which eventually led to a settlement agreement in the summer of 1987.[12]

The defendants, however, point out that BFI's Second Quarter 1987 Interim Financial Statement disclosed the existence of the settlement agreement. In addition, the settlement agreement is distinct from the alleged "safe and conservative" portrayal of the BFI investment, to which the plaintiffs should have discovered the alleged fraud based on the reasons discussed above.

The Majeski class also argues that the defendants waived the statute of limitations argument by waiting more than a year after the Short decision to bring their motion. The defendants argue that their answers to the amended complaint, given a few months after

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[12] A copy of the settlement agreement can be found attached as Ex. N to the Dec. 13, 1991 Kersten Aff.

the Short decision, stated the statute of limitations as an affirmative defense. This court finds no reason to conclude that the defendants waived this argument.

Eckstein

The absolute language of § 13 of the Securities Act of 1933 applies to the Eckstein class, i.e. "[i]n no event shall any such action be brought to enforce a liability created . . . more than three years after the sale" (emphasis added). In Short, the court noted that this language "sets three years after the sale as the outer limit for litigation." Short at 1392. Because the last possible day of receipt of the BFI prospectus and sale of BFI investments was December 31, 1985, the last day to file the Eckstein complaint within the three-year prong of the statute of limitations was December 31, 1988. The Eckstein complaint was filed on February 10, 1989, and must therefore be dismissed as untimely.

The Eckstein class also argues that the defendants' fraudulent concealment, as distinct from equitable tolling, applies to the statute of limitations. This court finds, however, that the Seventh Circuit law as expressed in Short imposes an absolute three-year limitation on actions brought pursuant to § 10(b) and Rule 10b-5.

IT IS THEREFORE ORDERED that the defendants' November 5, 1991 motion for summary judgment is GRANTED and the above-captioned actions are DISMISSED.

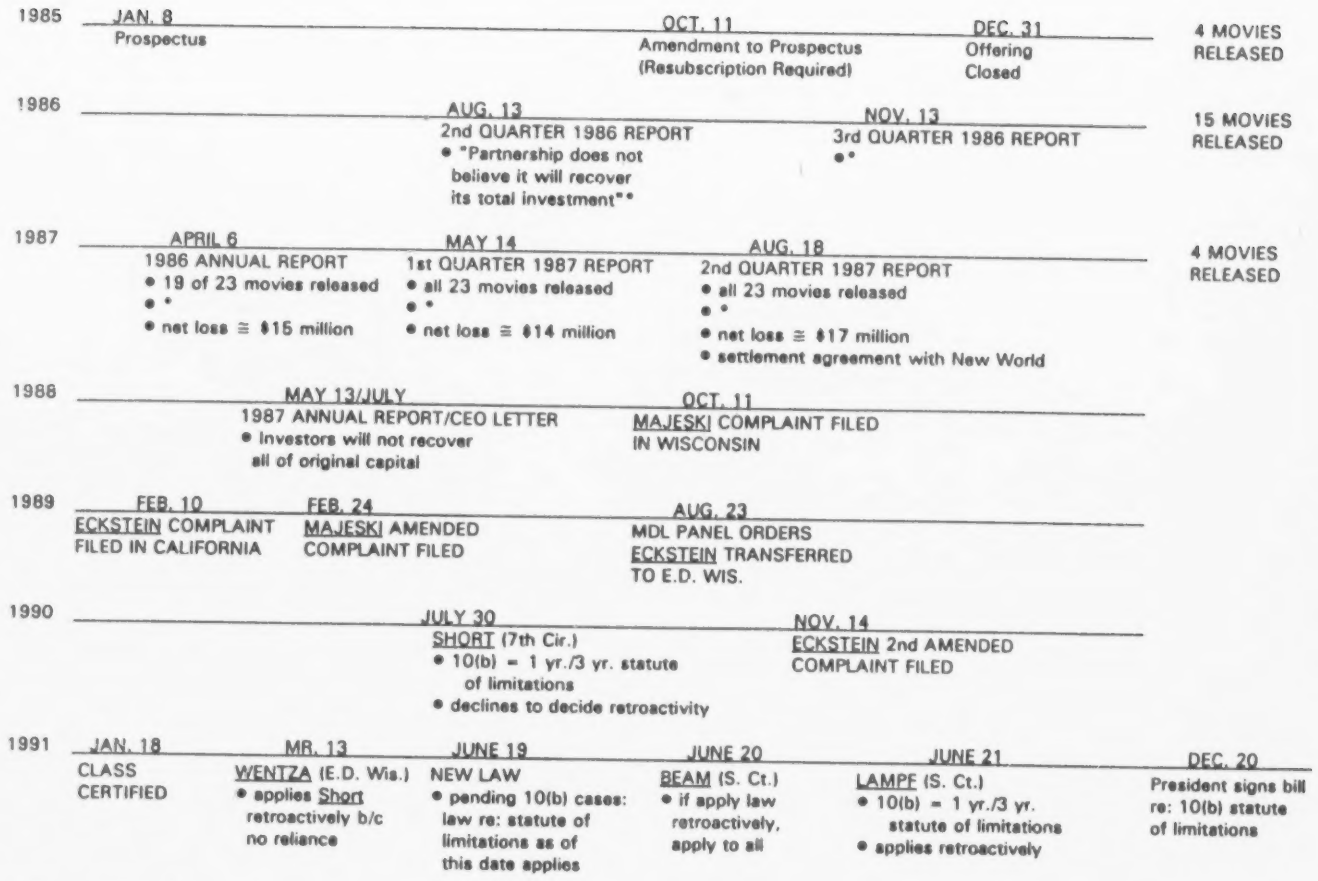
Dated at Milwaukee, Wisconsin, this 11th day of March, 1992.

BY THE COURT:

/s/ John W. Reynolds

John W. Reynolds
Senior Judge

EXHIBIT TO OPINION



* This language will be represented by an asterisk for subsequent reports.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

JUDGMENT IN A CIVIL CASE

RALPH MAJESKI, et al.,

v.

Case Number: 88-C-1079
John W. Reynolds, Judge

BALCOR ENTERTAINMENT
COMPANY, LTD., et al.

☐ Jury Verdict. This action came before the Court and a jury with the judicial officer named above presiding. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court with the judge named above presiding. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the defendant's November 5, 1991 motion for summary judgment is GRANTED and this action is hereby DISMISSED.

Date March 11, 1992

SOFRON B. NEDILSKY
Clerk

/s/ Rita Zvers
(By) Deputy Clerk

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

JUDGMENT IN A CIVIL CASE

ROBERT ECKSTEIN, et al.,

v.

Case Number: 89-C-1315
John W. Reynolds, Judge

BALCOR FILM INVESTORS, et al.

☐ Jury Verdict. This action came before the Court and a jury with the judicial officer named above presiding. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court with the judge named above presiding. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the defendant's November 5, 1991 motion for summary judgment is GRANTED and this action is hereby DISMISSED.

Date March 11, 1992

SOFRON B. NEDILSKY
Clerk

/s/ Rita Zvers
(By) Deputy Clerk